

Summary of Current System

	Pillar 1	Pillar 2	Pillar 3
Type:	◆ Defined-benefit	◆ Defined-contribution	
Participation:	◆ Mandatory	◆ Mandatory	
Management:	◆ Publicly-managed	◆ Privately-managed	
Financing:	◆ PAYGO	◆ Fully-funded	
Coverage:	◆ Wage earners and salaried employees in both public and private sector	◆ Employed and participating self-employed individuals	
Eligibility:	◆ Age 65 years for both men and women	◆ Age 65 years for both men and women	

Problems Leading to Pension Reform

- Economic instability
- Demographic shifts
- Generous benefits

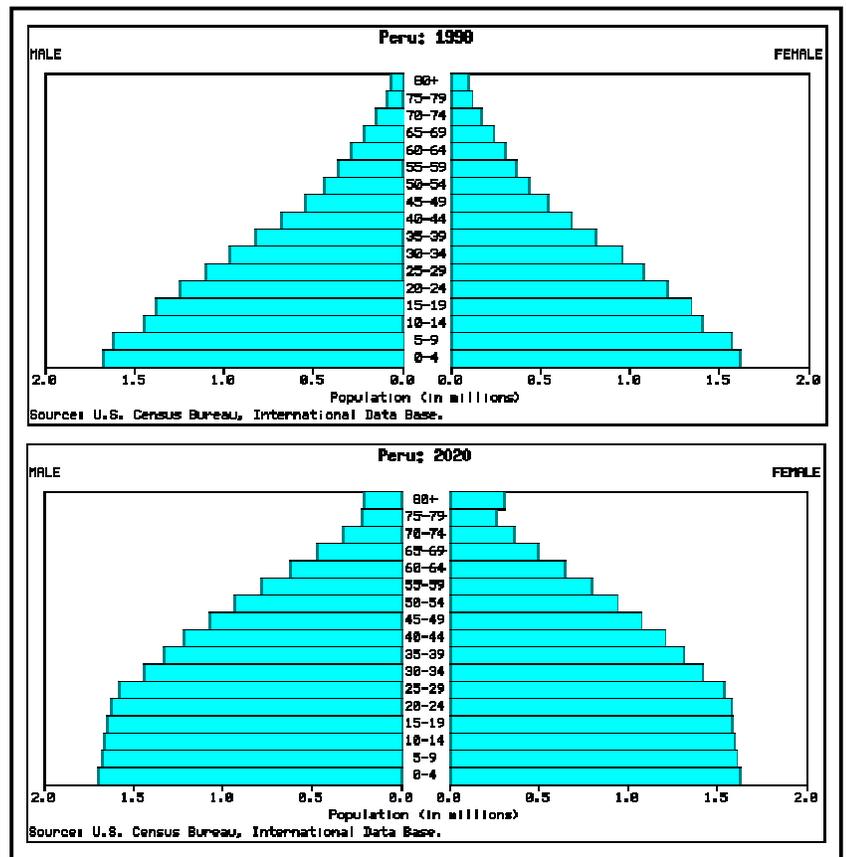
Summary of Current Pension System

Pension efforts in Peru combined the dual existence of public and private pension systems. The private pension system (called *Sistema Privado de Pensiones*, or the *SPP*) was introduced in 1993, modeled after pension reforms that had taken place in Chile almost a decade earlier. The Peruvian authorities established a defined-contribution scheme, privately managed by pension fund administrators, while retaining the existing public pay-as-you-go (PAYGO) scheme, called the *SNP* (*Sistema Nacional de Pensiones*). When the *SPP* was introduced, all workers were given an opportunity to choose between the public and private systems. However once workers have chosen the private system, they may not return to the public pension system. Participation is mandatory for both the public and private pension systems.

Several corrective measures were adopted in 1995 and 1996 to increase participation in the *SPP* by lessening the uneven competition between the two systems. Initially, the *SNP* had a lower retirement age (60 years and 55 years for men and women, respectively) than the private system. The retirement age, however, has been equalized for both systems at 65 years old for both men and women. In addition, contribution rates are scheduled to increase in January 1999. Workers remaining in the *SNP* will contribute 13 percent of earnings (up from 3 percent prior to reform efforts), while workers affiliated with the *SPP* will contribute 10 percent of earnings; employers do

not contribute. Furthermore, new labor market entrants are now automatically placed into the private pension system unless they have specifically requested affiliation with the *SNP* within ten days of employment.

The *SNP* generally covers wage earners and salaried employees. Voluntary coverage is available for the self-employed. Pension benefits vary between 50 percent and 100 percent of an individual's average salary, depending on the number of years of service. Workers who had previously made contributions to the public system and switched to the



SELECTED INDICATORS		
Demographic	Year	
	1998	2020
Total Population (in thousands)	26,111	36,897
Life Expectancy at Birth (Years)	69.97	77.12
Total Fertility Rate (Child Born per Woman)	3.31	2.26
Age Dependency Ratio (percent)	11.8	17.1
	1980-2000	2000-2020
Average Annual Rate of Population Growth (percent)	0.2	-0.2

Source: U.S. Bureau of the Census, International Data Base.

Economic	1996
GNP (PPP in billions) ¹	107.1
GNP Average Annual Growth Rate, 1995-1996 (percent) ¹	2.0
GNP Per Capita (in PPP) ¹	4,410
Inflation Rate (percent) ²	11.5
Labor Force Participation Rate (percent) ³	36.5
Unemployment Rate (percent) ³	7.0

Source: ¹World Bank; ²IMF; ³International Labour Office.

Pension	1997
System Dependency Ratio (percent)	n/a
Employee Contribution for Pensions (percent of earnings) ¹	
Public (SNP)	13.0
Private (SPP)	10.0
Employer Contributions for Pensions (percent of payroll) ¹	
Public (SNP)	None
Private (SPP)	None
Public Pension Spending as % of Government Spending	n/a
Public Pension Spending as % of GDP, 1996 ²	0.6

Source: ¹U.S. Social Security Administration; ²OECD.

private system will receive recognition bonds (*Bono de Reconocimiento*) to compensate them for past contributions.

The SPP covers all employed individuals and the self-employed, except for public sector employees who are covered under a separate pension system. Currently, each employee contributes 8 percent of gross earnings to their individual pension account. Individuals may begin receiving pension benefits at the normal retirement age, however, they may retire early if their accumulated contributions replace 50 percent of their average wage based on their last 10 years of employment. Retirement benefits vary according to the performance of the pension fund, and retirees have several options for disbursement of benefits. Workers are allowed to voluntarily contribute to their pension fund to increase their savings for retirement.

Contributions into private pension fund accounts began in July 1993 and employees may choose among five pension fund administrators. Workers are allowed to open only one pension fund account. As of April 1998, pension fund administrators managed US\$1.7 billion for approximately 1.8 million contributors.

Problems Leading to Pension Reform

Several factors initiated the reform of the public pension system in Peru. Contributions to the pension system were shrinking due to contribution evasion. The number of

contributors to the public pension system decreased from 34 percent in 1985 to 21 percent in 1992. Furthermore, the economic crisis that affected Peru and many other Latin American countries in the late 1980s resulted in erosion of pension fund reserves.

The number of individuals receiving pension benefits has also increased causing additional strain to a financially strained pension system. The old-age dependency ratio has risen due to demographic shifts in the population caused by decreasing fertility and mortality rates. Between 1985 and 1992, the number of current workers supporting retirees declined from an estimated 11 workers to 7 workers.

Current Pension Reform Efforts

Since the initial reform efforts, modifications have been necessary to maintain support for the privatization process and to increase public confidence in private pension funds. In the coming years, the pension system will be faced with additional challenges. First, the mixed public-private pension system will need increased participation among workers. Currently, 2.9 million workers participate in the public and private pension systems, representing about 40 percent of the labor force in urban areas. Second, the Peruvian government does not provide a minimum pension guarantee to workers participating in the private pension system. This minimum pension would provide assistance to individuals exposed to substantial risk due to lower than average investment returns or poor management by pension fund administrators. The government is considering providing such a safety net for affiliates of the private pension system. Third, pension fund administrators must have the flexibility to diversify their portfolio, especially with respect to developing standards for investing in foreign assets. Finally, the government will need to manage the deficits incurred by the public pension system. In 1997, the combined deficits from the public pension system amounted to 1.7 percent of GDP.

Pension Reform Efforts by Pillar

	Pillar 1	Pillar 2	Pillar 3
Papers issued on state of pension systems	✓	✓	✓
Formulation of proposals	✓	✓	✓
Development of draft legislation	✓	✓	✓
Introduction of legislation by parliament	✓	✓	✓
Review of legislation by parliament	✓	✓	✓
Passage of legislation by parliament	✓	✓	✓
Implementation of legislation	✓	✓	✓